DON'T BE FOOLED

New Industry Report Ignores the Bottom Line: Direct Loans Save Taxpayer Money

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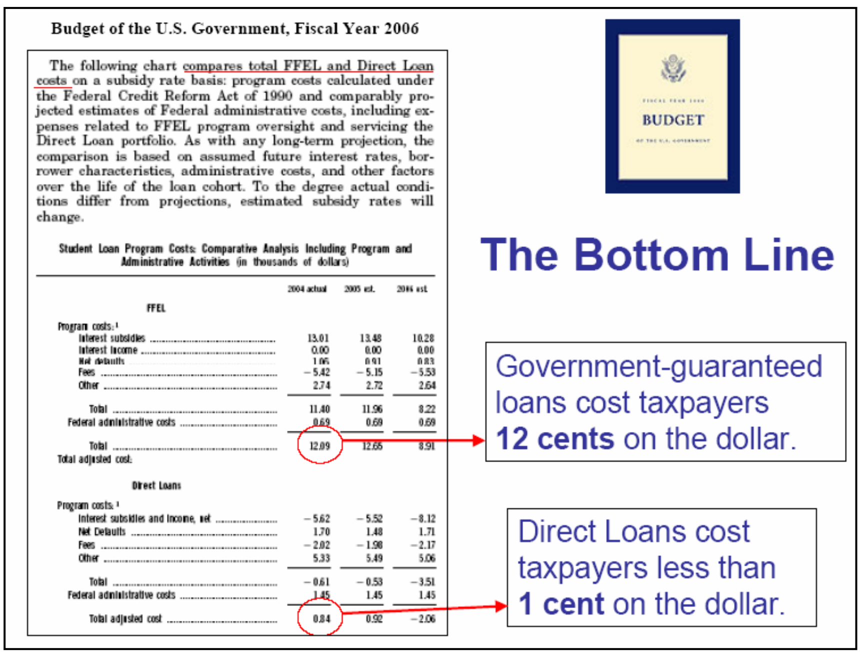
- **It is a fact—not a theory—that direct student loans save money.** Government-guaranteed student loans are made through a heavily subsidized and overly complex program (the FFEL program). Direct loans are simpler and cheaper *and more private sector*. The costs have been verified year after year by the nonpartisan government experts at the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and the Government Accountability Office (GAO), based upon more than a decade of actual experience with both programs.

- **This year, direct loans could save $9 billion.** In 2006, guaranteed loans will cost $8.91 for every $100 in loans, while direct loans will actually earn $2.06. That's an $11 difference. (OMB, *FY 2006 Budget Appendix*, p. 371.) If all of this year's $78 billion in guaranteed loans were direct loans, taxpayers would save more than $9 billion. (The precise figures change somewhat from year to year due to interest rate variations and other factors.)



Budget of the U.S. Government, Fiscal Year 2006

The following chart compares total FFEL and Direct Loan costs on a subsidy rate basis: program costs calculated under the Federal Credit Reform Act of 1990 and comparably projected estimates of Federal administrative costs, including expenses related to FFEL program oversight and servicing the Direct Loan portfolio. As with any long-term projection, the comparison is based on assumed future interest rates, borrower characteristics, administrative costs, and other factors over the life of the loan cohort. To the degree actual conditions differ from projections, estimated subsidy rates will change.

Student Loan Program Costs: Comparative Analysis Including Program and Administrative Activities (in thousands of dollars)

	2004 actual	2005 est.	2006 est.
FFEL			
Program costs:[1]			
Interest subsidies	13.01	13.48	10.28
Interest income	0.00	0.00	0.00
Net defaults	1.06	0.91	0.83
Fees	−5.42	−5.15	−5.53
Other	2.74	2.72	2.64
Total	11.40	11.96	8.22
Federal administrative costs	0.69	0.69	0.69
Total	12.09	12.65	8.91
Total adjusted cost:			
Direct Loans			
Program costs:[1]			
Interest subsidies and income, net	−5.62	−5.52	−8.12
Net Defaults	1.70	1.48	1.71
Fees	−2.02	−1.98	−2.17
Other	5.33	5.49	5.06
Total	−0.61	−0.53	−3.51
Federal administrative costs	1.45	1.45	1.45
Total adjusted cost	0.84	0.92	−2.06

- **PriceWaterhouseCoopers does not claim otherwise.** The recent report commissioned by the student loan industry never claims that guaranteed loans are cheaper than direct loans. Nor does it provide the dollar figure by which it believes federal cost estimates are biased. Instead, it suggests imperfections in the budget methodology to obscure the larger truth.

- **The report is intended to create confusion.** For example, it says direct loans produce "net losses" in most years (p. 14), without mentioning that guaranteed loans produce net losses that are *many times larger*. It says that direct loans have "failed to generate the budgetary savings—the original justification for the program," as if it is not enough that direct loans are billions of dollars cheaper than guaranteed loans (p. 10). The implication is that direct loans should have no net cost at all, while the cost *difference* between the two programs is immaterial!

The Real Facts about PriceWaterhouseCoopers' Three Findings

Claim #1: *The budget underestimates the gap between long-term and short-term interest rates, which make direct lending appear to be less expensive than it is. Past estimates of direct loan "profitability" have been inaccurate.*

OMB routinely updates its cost estimates to reflect experience. According to the GAO, these changes are not only reasonable, but required (Letter to Sen. Kennedy, 6/30/04). These changes are molehills compared to the amount that direct loans save taxpayers. As shown in a recent OMB table—cited only in part by PriceWaterhouseCoopers—direct loans remain far less expensive for taxpayers even after the adjusted estimates. If the figures below from OMB are adjusted for loan volume, the total cost difference is $30 billion.

Total Student Loan Subsidy Costs, 1992-2004

	Guaranteed Loans	Direct Loans
Original Estimates	$46 billion	- $2 billion
Cumulative Adjustments to Estimates	- $7 billion	$5 billion
Total Subsidy Costs	**$39 billion**	**$3 billion**

Source: OMB, *FY 2006 Budget Appendix*, p. 371.

Claim #2: *The budget fails to take into account the tax revenues produced by the FFELP program.*

The lenders are suggesting that we waste money on corporate welfare so that we can tax the profits and the executives' high salaries. But a balanced analysis would look at the opportunity costs. What else could we do with that money? Closing the college opportunity gap by helping low-income students go to college would bring in $85 billion in tax revenue—more than 100 times more than the $631 million in revenue from taxes that PriceWaterhouseCoopers claims for the loan industry.

Moreover, PriceWaterhouseCoopers assumes that companies pay the 35% corporate tax rate, a questionable assumption. Due to tax shelters, many large corporations pay less than half that rate, according to the Citizens for Tax Justice (9/22/04).

Claim #3: *The budget omits administrative costs from direct loan cost estimates, but not from FFELP estimates.*

All the costs of both programs are reported in the budget. Although OMB and CBO are required to draw a distinction between the two types of costs (subsidy costs and administrative costs), they publish both of them. All cost estimates are readily available. The cost estimates from the White House budget—which conclude that a $100 guaranteed loan costs taxpayers approximately $11 more than a $100 direct loan—include administrative costs.